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Organization for the Promotion and Advancement of Small Telecommunications Companies

Ex Parte Presentation

CC Docket No. 96-45

Federal-State Joint Board on Universal Service

Joint Board proceeding on the
rural high-cost mechanism to succeed the
Rural Task Force Order

July 14, 2005

Three Fundamental Recommendations

1. Support for all ETCs in rural service areas – ILECs and CETCs – should be based on their own embedded costs.
2. The existing support calculation methodology for rural ILECs should be maintained, based on study area average network costs.
3. The complete statutory definition of “rural telephone company” should continue to be used for determining which carriers are “rural” for universal service purposes.

Support for rural ILECs should remain based on their embedded costs

- Rural ILEC support, based on actual embedded costs, has been highly successful in achieving the 1996 Act's universal service objectives.
- It has encouraged prudent network investment, resulting in quality services that are reasonably comparable to those offered in urban areas and at affordable and reasonably comparable rates.
- The Joint Board should not tamper with a basis of support that is accomplishing what it is intended to do.

Support for rural ILECs should remain based on their embedded costs

- The use of embedded costs has been instrumental to rural ILECs' ability to deploy the multi-functional infrastructure capable of providing advanced services.
- The deployment of facilities capable of providing advanced services in rural areas is costly and risky.
- The use of embedded costs creates a direct link between actual network investment and the support received. It is this predictability and specificity to each rural ILEC's costs that has encouraged prudent investment in infrastructure.

Support for rural ILECs should remain based on their embedded costs

- FLEC-based support breaks the link between a rural ILEC's network investments and the support they receive.
- FLEC-based support unrealistically assumes a flashcut to the least-cost, most efficient technology. It fails to account for much of the cost already incurred by rural ILECs in the gradual buildout and modernization of their networks.
- FLEC-based support therefore calls into question whether funding will be sufficient to enable the full recovery of network investments, even though those investments were efficient and prudent at the time they were made.
- This would erect a substantial barrier to infrastructure investment and the further deployment of advanced services.

Support for rural ILECs should remain based on their embedded costs

- Even if FLEC-based support were appropriate, it has yet to be demonstrated that a FLEC model can be developed that would consistently produce reasonable estimates of FLEC for the diversity of rural ILECs.
- Rural ILECs do not have the ability to “average out” discrepancies in a model’s cost calculations for individual wirecenters, which could potentially leave a carrier with a serious deficiency in “sufficient” support.

Support for rural ILECs should remain based on their embedded costs

- The use of embedded costs does not incent rural ILECs to operate inefficiently, as advocates of FLEC like to claim. Rural ILECs have a great deal of incentive to operate efficiently:
 - High-cost support comprises only a portion of ILECs' total revenues.
 - Rural ILECs face significant competitive threats from wireless, VoIP, and IXC access bypass.
 - By operating efficiently, carriers create value for consumers, thereby increasing demand for their services.
 - Rural ILECs face scrutiny and oversight from auditors, regulators, lenders and shareholders.



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Support for CETCs in rural service areas should be based on their own embedded costs

- Would result in payments that are “sufficient” but not more so, and “specific” to each carrier’s own circumstances, consistent with Sec. 254(b)(5) of the 1996 Act.
- Would promote compliance with Sec. 254(e) requirement that support only be used for the provision, maintenance and upgrading of facilities and services for which the support is intended.
- Would promote efficient competitive entry in high-cost rural service areas. Carriers would no longer have perverse incentives to seek ETC status merely to receive windfall support payments that enrich shareholders at the expense of ratepayers nationwide.
- Using the same support calculation methodology for all ETCs in rural service areas is competitively neutral.



Support for CETCs in rural service areas should be based on their own embedded costs

- The identical support rule is not competitively neutral and provides CETCs with an unfair competitive advantage.
- A rural ILEC's higher costs do not reflect inefficiencies. ILECs and CETCs are not at all similarly situated:
 - Rural ILECs provide a higher quality service than most CETCs (ex. service availability, reliability, capacity, bandwidth, E911 coverage, equal access, etc.)
 - Rural ILECs are subject to regulatory obligations and standards not imposed on most CETCs (ex. COLR, service quality standards, billing requirements, rate regulation, etc.)
 - CETCs are often designated for only a portion of a rural ILEC's study area.
 - Rural ILECs lack the economies of scale of large wireless carriers.
- Equal per-line support for carriers with different levels of service, different regulatory obligations, different service areas, and different economies of scale is the opposite of competitive neutrality.



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Support for CETCs in rural service areas should be based on their own embedded costs

- When CETCs are able to receive windfalls of support based on the ILEC's costs, it places unnecessary strain on the rural High-Cost program.

RURAL HIGH COST SUPPORT PROGRAM – USAC QUARTERLY PROJECTIONS (\$ Millions)

	3Q 2003	3Q 2004	3Q 2005	%Change 3Q'03-3Q'05	Two Year Support Increase	% of Total Two Year Support Increase
ILEC	\$607.1	\$631.3	\$630.9	3.9%	\$ 23.8	21.5%
CETC	\$ 49.5	\$108.0	\$136.2	175.2%	\$ 86.7	78.5%
Total	\$656.6	\$739.3	\$767.1	16.8%	\$110.5	100%

- Basing support for all ETCs in rural service areas on their own embedded costs would effectively address the wasteful payout of windfall support amounts, while still ensuring that all ETCs receive sufficient support to encourage investment and provide universal service.



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Support for CETCs in rural service areas should be based on their own embedded costs

- The Joint Board and/or FCC should hold industry workshops to develop the accounting mechanisms through which CETCs in rural service areas would be required to report their embedded costs.
 - Attention should initially be focused on the cost reporting rules for wireless CETCs since they presently receive most of the high-cost support going to CETCs in rural service areas.
- Consideration should be given to developing an average schedule-like option for CETCs. This would provide CETCs with a choice between submitting their own cost study or relying on formulas that simulate the embedded costs of similarly situated carriers using the same technology.



Support for CETCs in rural service areas should be based on their own embedded costs

- During the period while accounting rules for CETCs are being developed, the interim “safe harbor” plan filed by the Rural Telecommunications Associations should be adopted.
(See comments filed 8/6/04 in 96-45)
- Under the interim plan wireless CETCs would receive a “safe harbor” percentage of the rural ILEC’s per-line support, with the specific percentage based on the size of the wireless carrier.
- Wireless CETCs should be permitted to have their support determined by the safe harbor percentages up until a certain sunset date, to be determined by the FCC. This would give wireless CETCs a transition period to internally adopt the cost accounting procedures established for them.

Rural ILECs should continue to have their support calculated based on study area average network costs

- Rural ILEC support should continue to be based on their total network costs in order to maintain sufficient support for the maintenance and upgrading of network facilities and to achieve “reasonably comparable” services and rates.
- Rural ILECs build networks designed to provide service throughout an entire study area which must be maintained under COLR obligations. Rural ILECs have high fixed costs and the loss of subscriber lines are not offset by corresponding reductions in network costs.
- In the RTF Order, the FCC correctly found that freezing per-line support in competitive study areas may discourage investment in rural infrastructure.



Rural ILECs should continue to have their support calculated based on study area average network costs

- Statewide average costs should not be used to determine rural ILECs' eligibility for high-cost support. It would unfairly leave many high-cost rural carriers ineligible to receive any federal funding, due to the unrelated costs of the large non-rural carriers that determine a state's average costs.
- Unlike non-rural carriers, rural ILECs do not have large, low-cost metropolitan cores that they can use to offset the high cost of their sparsely populated rural territories.
- The use of statewide average costs would seriously hinder many rural ILECs' ability to continue investing in their networks, and to continue providing affordable, high quality service.



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The full statutory definition of “rural telephone company” should continue to be used for determining which carriers are “rural” for universal service purposes

- Sec. 214(e) of the 1996 Act demonstrates that the definition of “rural telephone company” was developed with universal service in mind and is well-suited for use in determining which carriers should be subject to a rural high-cost support mechanism.
- The Joint Board should not seek to substitute its own definition of “rural” for the singular definition established by Congress.
- Reducing the number of ILECs deemed to be “rural” fails to directly address the primary cause of growth in the rural High-Cost program – the excessive funding going to CETCs as a result of the irrational identical support rule.

The full statutory definition of “rural telephone company” should continue to be used for determining which carriers are “rural” for universal service purposes

- Reducing the number of ILECs deemed to be “rural” would not be very effective in reducing the size of the Fund since the amount of support received by the largest rural telephone companies is relatively small.
- Rural study areas with more than 100,000 lines account for 46 percent of all rural ILEC access lines. However, these study areas receive only 10 percent of rural ILEC support.
(Source: USAC 3Q 2005 Fund Size Projections)
- What this data reveals is that under a cost-based system of support, to the extent that larger rural carriers have lower per-line costs, the mechanism appropriately provides them with less support, if any at all.



Conclusions

- There is no reason for the Joint Board to recommend altering a support mechanism for rural ILECs that is already rational, accountable and achieving the objectives of Section 254.
- Instead, the Joint Board should focus on basing support for CETCs in rural service areas on their own costs in order to introduce rationality, accountability and competitive neutrality into the mechanism for these carriers.

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